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SUBJECT: German State-Level Stimulus Aims to Offset Industrial
Slump

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11. SUMMARY: As evidence mounts that Germany has slid into recession, the Baden-Wuerttemberg state government announced this week it will provide its own fiscal stimulus package to combat the coming crisis. Automotive and industrial manufacturers in B-W will undoubtedly welcome the news, having already seen a sharp decline in global demand for their products. Business leaders expect numerous insolvencies and large production cuts in the coming year, especially among small auto parts manufacturers. Although the state's package will not be large enough to prevent the downturn, it may encourage other states or the federal government to provide their own larger fiscal stimulus packages. END SUMMARY.

State-Level Fiscal Stimulus on the Way -----

12. Baden-Wuerttemberg Minister President Guenther Oettinger announced this week a 1 billion euro (\$1.27 billion) economic stabilization package to modernize transportation and education infrastructure in B-W. Oettinger's announcement came as a surprise because he had just the previous week publicly backed Chancellor Angela Merkel's opposition to a stimulus package larger than her now-approved 12 billion euro plan. Oettinger justified his change of heart by saying that the state's dependence on the automotive sector makes the crisis more acute in B-W than elsewhere. The CDU's coalition partner in the state, the Free Democratic Party, would prefer to see tax cuts, but most parties reacted favorably to the news.

13. The announcement comes as economic misery has become reality in Germany's southwest; leading industrial manufacturers have announced reduced production and profit targets. Baden-Wuerttemberg, Germany's third largest state in economic size, has consistently outperformed other states in growth and employment statistics. With an unemployment rate of only 4%, economic growth rates of 4.4% in 2006 and 2.8% in 2007, and a GDP of 353 billion euros (\$448 billion) in 2007, B-W consistently scored well above the national average in its economy. Although optimistic prognoses still put economic growth at 2% for 2008, predictions for 2009 are being revised ever downward. In the Stuttgart area, the automotive sector accounts for 51% of turnover and employs 121,000 people. As the recession deepens in Germany, the B-W economy, with its large automotive and industrial manufacturing sectors, has been hit hard by the global collapse in demand for industrial products.

Automotive Sector Already in Hard Times

¶4. Stuttgart-based Daimler, manufacturer of Mercedes and Smart brands, saw a dramatic reduction in sales in October and November, down 25% from the previous year. Daimler now plans to reduce production by 80,000-100,000 cars in 2008 and 150,000 in 2009. In addition to a five-week Christmas break and several days of production stops in February and March, Daimler will also add a summer recess in 2009. In addition to cuts in part-time positions, Daimler announced on December 8 that it will go to a four-day work week for 20,000 of its 30,000 employees at its largest assembly plant in Sindelfingen (near Stuttgart). An additional 6,100 workers at the nearby Rastatt plant will also work only 3 to 4 days a week, but the firm will resist making job cuts. B-W's other leading auto manufacturer, Porsche, will also extend production shutdowns over the holidays and cancel 100 temporary contracts.

¶5. Daimler chief economist Juergen Mueller predicted to Econ Off and Econ Spec that the German auto industry would not see a return to 2006 and 2007 sales levels until 2011 or 2012. Some factors will have a positive effect on sales, such as the decreasing cost of oil, lower raw material prices, and the weakening of the euro against other global currencies, but a global economic downturn will have a devastating impact on demand. He worried most about small-parts manufacturers, predicting that 20-25% will slide into bankruptcy this year, even more should any U.S. auto manufacturers go bankrupt. Although Daimler faces increased borrowing costs, it stands ready to reach out to its partners by paying for orders upfront or earlier than usual. Mueller predicted that the German government may in the end need to create a stabilization package for the auto parts industry.

Other Industries See Dark Clouds Ahead

¶6. Suedwestmetall, an employer association representing more than 800,000 employers in the metal and electric industries, sees similar trends in other industrial sectors. Managing Director Peer-Michael Dick described the present situation as catastrophic. The speed and depth of the current downturn surprised industrial manufacturers, and the recession would affect B-W harder due to its dependence on industrial output. He expected up to 33,000 bankruptcies among manufacturers and upwards of 140,000 lay-offs in the state in 2009.

¶7. Dick criticized the federal government's 12 billion euro financial stimulus package as totally inadequate and said that if the German government refused to take action, the auto industry would need help from the EU. Both he and Daimler's Mueller argued that a cut in the value-added tax would boost consumption in Germany. Both parties agreed that this recession would be particularly tough, as what might have been a normal business cycle downturn coincided with a financial crisis.

¶8. COMMENT: The 1 billion euro infrastructure package from the state government will clearly not be large enough or come quickly enough to prevent a severe economic recession in B-W. Nevertheless, the change of heart in the state government shows increasing acceptance of fiscal stimulus despite the federal government's intractability and prior state-level commitments to a balanced budget. As fiscal stimulus gains acceptance at the state level and poor economic data continues to come in, resistance at the federal level may also dissipate. END COMMENT.

¶9. This cable was coordinated with Embassy Berlin.
POWELL